No. 17,313

IN THE

United States Court of Appeals

For the Ninth Circuit

Francis L. Rooney and Irene Rooney, his wife,

Appellants,

vs.

United States of America,

Appellee.

REPLY BRIEF FOR APPELLANTS FRANCIS L. ROONEY AND IRENE ROONEY

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PRELIMINARY STATEMENT

This brief is directed principally to the Government's argument on a purported issue as to burden of proof. For appellants' position on the only issue of substance in this case, we respectfully refer the Court's attention to our opening brief.

ARGUMENT

I.

APPELLANTS HAVE ESTABLISHED WITH EXACTITUDE THE SPECIFIC RECOVERY TO WHICH THEY ARE ENTITLED

In an effort to obfuscate the critical issue in this case, the Government devotes its initial argument (Br.

6-9) to a completely baseless hypothesis, namely, that the record does not disclose the exact sum of money which the Government has wrongfully exacted and now holds.

The mechanics of the establishment and collection of this deficiency have been described in the briefs of both parties. To repeat, the District Court's opinion states that the Commissioner, by allocating the expenses incurred by appellants in connection with the crop subsequently transferred to their corporation, denied them individually a deduction for those expenses (R. 20-21). The basis for this allocation was an audit of taxpayers' returns for the years in question. The audit involved an evaluation of all income and expenses reported by appellants during the period examined. The sole challenge to the correctness of those returns related to the crop expenses. Since income, as reported by appellants, was not questioned, a simple recomputation of their individual tax liability was made after the expense items were eliminated.

Appellants paid the additional tax as computed by the Government, filed claims for refund and, upon their disallowance, commenced this action in timely fashion. As is universally the case, the filing of the claim for refund led to a second audit by the Government of the entire returns of appellants and, again, the sole question was whether appellants individually were entitled to deduct these expenses.

Neither the propriety of deducting these expenses as ordinarily and necessarily incurred in the carrying on of a trade or business nor their exact amount has

been in dispute at any stage of the administrative or judicial proceedings. Appellants' complaint (R. 4) alleged both the precise amounts that the District Director of Internal Revenue proposed as deficiencies and the payment of those amounts together with statutory interest. These allegations were admitted in the Government's answer (R. 18).

Ignoring the clarity of the record, the Government indulges itself in the sophistical contention that appellants have, in some inexplicable fashion, failed to prove the sum they are entitled to recover. Attempting to buttress this assertion, the Government cites numerous authorities, none of which are even remotely apposite to the facts of the instant case.* Placing principal reliance upon *Roybark v. United States* (9th Cir. 1954), 218 F.2d 164, the Government finds it "virtually on all fours" with the case at bar. Yet a cursory examination of the facts of that case reveals their fundamental difference from the situation here. In *Roybark,* because of the inadequacies of the taxpayer's records, the Commissioner had to *estimate* a deficiency. Although holding for the taxpayer on the merits, this Court refused to conjecture as to the correct tax liability. The Government's computation had always been in dispute and taxpayer had failed to

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*Appellants have no quarrel with the cases of *Stone v. White* (1937), 301 U.S. 532, and *Champ Spring Co. v. United States* (8th Cir. 1931), 47 F.2d 1, neither of which involved the taxpayer's burden of proof in a refund action. These cases require a taxpayer's refund action to be consonant with equitable principles, which this suit doubtless is, assuming the Commissioner has wrongfully invoked Section 482.

sustain his burden of proving the amount wrongfully withheld.

There has never been any similar dispute as to computation in the instant case. No estimate ever was or is necessary. It would have been surplusage for appellants to introduce into evidence their income tax returns, books of accounts or tax returns of their successor corporation in light of the lack of any issue either on the computation of the deficiency or on the fact that the only additional tax liability, after two audits by the Government, hinges on this specific disallowance of expenses.

Maroosis v. Smyth (9th Cir. 1951), 187 F.2d 228 and *Decker v. Korth* (10th Cir. 1955), 219 F.2d 732, also involved estimates by the Commissioner as to the amount of a deficiency. Both cases held that taxpayers must not only prove the Commissioner's computation to be incorrect but also must establish by their own evidence the correct amount of the tax liability. As stated in *Helvering v. Taylor* (1934), 293 U.S. 507, a refund action imposes upon the taxpayer the burden of proving with exactitude the amount of his overpayment; where a deficiency results from the Commissioner's estimate, necessitated by the inadequacies or insufficiencies of the taxpayers' own records, then the error of that estimate must be proved. But there has been no conjecture as to the deficiency here. Both appellants and the Government agree on the mathematical accuracy of the latter's computation.

In connection with *Helvering v. Taylor,* it is interesting to note that the Supreme Court rejected the

notion that a taxpayer could, merely because he failed to show the exact amount of tax he might owe, be required to pay a tax deficiency resulting from an improper exercise of the Commissioner's authority. In that case the taxpayer's position on the merits was upheld and his failure of proof, again resulting from failure to show the error in a speculative computation by the Commissioner, resulted in the matter being remanded to establish the amount of the refund owing.

In *Lewis v. Reynolds* (1932), 284 U.S. 281, the Court simply held that the Government's audit in connection with a claim for refund properly encompasses a redetermination of the taxpayer's entire tax liability. As shown above, the refund audit of appellants' returns here resulted in no assessment of liability other than that in issue in this case. *U. S. v. Harris* (5th Cir. 1954), 216 F.2d 690, involved a failure by the taxpayer to establish either the fact or the amount of payments which would have constituted allowable deductions. *United States v. Pfister* (8th Cir. 1953), 205 F.2d 538, involved a speculative assessment by the Commissioner where the taxpayer had failed to maintain adequate records from which the precise amount of the tax liability could be ascertained.

An analysis of all of these cases leads inescapably to the conclusion that there is no authority for the proposition that these appellants have failed to sustain any supposed burden of proving the amount of money which they are entitled to recover. Conclusion of law 5 (R. 40) that "Plaintiffs failed to sustain

the burden of proof'' is ambiguous in that it cannot be determined whether this conclusion adverts to the merits of the cause or the amount of money in issue. In either respect, it is clearly erroneous.

Nor is there any merit in the Government's adroit, if inaccurate, statement that the District Court so held and ''that it properly dismissed taxpayers' complaint'' (Br. 9). The District Court obviously rendered its decision on the merits, and its opinion does not even comment on this argument of the Government.

II.

THE COMMISSIONER'S ALLOCATION IS NOT SUSTAINED BY PERTINENT AUTHORITY

The cases cited by appellee relevant to the issue at bar have been fully discussed in appellants' opening brief, with the exception of *Tennessee Life Insurance Company v. Phinney* (5th Cir. 1960), 280 F.2d 38. The facts of that case closely parallel those of *Simon J. Murphy v. Commissioner of Internal Revenue* (6th Cir. 1956), 231 F.2d 639. In its reluctant refusal to follow the holding of the *Murphy* case, the majority opinion rested in large measure on two cases from the Fifth Circuit holding that the obligation for ad valorem taxes had not ''accrued'' prior to the date of the distribution in liquidation and, accordingly, it was not at that date fully deductible by the transferor. This rationale is obviously inapplicable to the instant case as the expenses here allocated had

actually been paid by the appellants. It should be noted that, in spite of the authorities which the majority felt impelled to follow, Circuit Judge Cameron dissented on the ground that the holding of the *Murphy* case should be followed.

Since the filing of appellants' opening brief, the Tax Court has rendered its decision in *South Lake Farms, Inc. v. Commissioner of Internal Revenue* (1961), 36 T.C. No. 106 which involved facts similar to this case. The Tax Court rejected the Commissioner's attempt to attribute income from the sale of unharvested crops realized by a transferee in liquidation to the transferor. In its first ground of decision, the Court followed *Elsie SoRelle* (1954), 22 T.C. 459 which also rejected an attempt by the Commissioner to treat the income from the sale of unharvested crops in the hands of certain donees as the income of their donor.

The relevance of the holding in the *South Lake Farms* case is that the income from sale of unharvested crops can be properly realized by the transferee, even though the expenses of producing those crops have been borne by the transferor. The Court ruled that unfavorability to the Government of the immediate tax effects does not justify the Commissioner in ignoring the history of the transaction.

CONCLUSION

For the foregoing reasons, together with the authority cited in appellants' opening brief, the decision of the District Court is in error and should be reversed.

Dated, San Francisco, California,
October 2, 1961.

Respectfully submitted,
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